

26 CFR 1.263(a)-1: Capital expenditures; in general.
(Also: Part I, §§ 162, 167, 168, 446, 481; 1.167(a)-11, 1.168(i)-4, 1.446-1)

Rev. Proc. 2015-12

SECTION 1. PURPOSE

This revenue procedure provides several safe harbor methods of accounting for certain property costs paid or incurred by cable system operators. Specifically, this revenue procedure provides two alternative safe harbor approaches for determining whether expenditures to maintain, replace, or improve cable network assets must be capitalized under § 263(a) of the Internal Revenue Code (Code): (1) a “network asset maintenance allowance” method; and (2) a “units of property” method. In addition, this revenue procedure provides two alternative methods for determining whether costs for installations and customer drops may be deducted as repairs under § 162 or must be capitalized as improvements under § 263(a): (1) a “specific identification” method; and (2) a safe harbor method. This revenue procedure also permits a taxpayer to treat a fiber optic transfer node and trunk line consisting of fiber optic cable used in a cabledistribution system as the asset for depreciation purposes. This revenue procedure also provides a safe harbor method for determining whether all cable

distribution network assets are primarily used for providing one-way or two-way communication services. Finally, this revenue procedure provides procedures for a qualifying taxpayer to obtain automatic consent from the Commissioner of Internal Revenue to change to the safe harbor methods of accounting provided in this revenue procedure.

SECTION 2. BACKGROUND

.01 Cable system operators and their affiliates that provide video, high-speed internet, and voice-over-internet-protocol (VOIP) phone services incur significant costs to maintain, replace, and improve the real and personal property used to provide these services. Whether these costs may be deducted as repairs under § 162 or must be capitalized as improvements under § 263(a) depends on whether the costs are for a betterment to the unit of property, restore the unit of property, or adapt the unit of property to a new or different use. See §§ 1.162-4 and 1.263(a)-3(d). Applying capitalization principles to assets used in a cable system can be particularly difficult, largely because the property consists of a network of interconnected items. Taxpayers and the Internal Revenue Service (IRS) often have difficulty identifying the units of property that comprise these networks and therefore disagree over whether the cost to replace a particular item (or the cost of a customer drop) is an improvement that must be capitalized.

.02 To reduce disputes regarding the deductibility or capitalization of expenditures to maintain, replace, or improve cable network assets, this revenue procedure provides two alternative safe harbor approaches for determining the amount of expenditures that can be deducted as repairs under § 162 or must be capitalized as

improvements under § 263(a). Section 5 of this revenue procedure provides a “network asset maintenance allowance” method for cable network assets, which provides a simplified method for a taxpayer to determine the portion of costs capitalized for financial statement purposes that, for Federal tax purposes, may be deducted as repairs under § 162 or must be capitalized as improvements under § 263(a). As an alternative, section 6 of this revenue procedure defines “units of property” that, if properly applied under the principles of § 263(a), will not be challenged by the IRS.

.03 To reduce disputes regarding the deductibility and capitalization of costs for installations and customer drops (as defined in section 4.13 of this revenue procedure), section 7 of this revenue procedure provides two alternative methods for determining whether these costs may be deducted as repairs under § 162 or must be capitalized as improvements under § 263(a): (1) a “specific identification” method; and (2) a safe harbor method. The specific identification method clarifies that the costs of internal drops, drop replacements, and installing customer premises equipment may be deducted, while the costs of installing initial external drops (as defined in section 4.14 of this revenue procedure) must be capitalized. The safe harbor method provides a simplified allocation methodology for determining which customer drop costs are for external drops and which are for internal drops (as defined in section 4.15 of this revenue procedure) or drop replacements.

.04 Revenue Procedure 2003-63, 2003-2 C.B. 304, provides a safe harbor method under which the IRS will treat a fiber optic transfer node and trunk line consisting of fiber optic cable used in a cable distribution system providing one-way and two-way communication services as the asset for computing depreciation under §§ 167

and 168. Section 8 of this revenue procedure incorporates this safe harbor, clarifies that the definitions in section 8 of this revenue procedure apply only for purposes of §§ 167 and 168, and supersedes Rev. Proc. 2003-63.

.05 Revenue Procedure 2003-63 also provides guidance on acceptable ways for determining whether the asset described in section 2.04 of Rev. Proc. 2003-63 primarily is used, within the meaning of § 1.167(a)-11(b)(4)(iii)(b), for providing one-way or two-way communication services. In particular, Rev. Proc. 2003-63 provides that taxpayers may use any reasonable manner that is consistently applied to determine how the asset primarily is used. To reduce disputes regarding whether a taxpayer's manner of determining primary use for cable distribution network assets is reasonable, taxpayers requested more specific guidance on acceptable manners for determining whether cable distribution network assets primarily are used for providing one-way or two-way communication services. Section 9 of this revenue procedure restates the guidance originally provided in Rev. Proc. 2003-63, extends application of the guidance to all cable distribution network assets described in asset class 48.42 (CATV-Subscriber Connection and Distribution Systems) of Rev. Proc. 87-56, 1987-2 C.B. 674, and provides a new safe harbor manner for determining primary use for cable distribution network assets. While the safe harbor for determining primary use provided in this revenue procedure only applies to cable system operators, disputes have also arisen regarding the primary use of similar assets held by wireline telecommunication service providers that are used to provide video, high-speed internet, and voice communication services. It is anticipated that future guidance will provide a safe harbor manner similar to the manner provided in this revenue procedure for determining the primary use of

assets held by a wireline telecommunications service provider used to provide video, high-speed internet, and voice communication services.

.06 A change to use any of the safe harbor methods provided in sections 5 through 7 of this revenue procedure for determining whether a cost of tangible property is deductible or is required to be capitalized is a change in method of accounting under § 446(e) and § 1.446-1(e)(2)(ii)(a). In addition, a change to the depreciation safe harbor method of accounting provided in section 8 of this revenue procedure is a change in method of accounting under § 446(e) and § 1.446-1(e)(2)(ii)(d). Except as otherwise expressly provided in the Code and the regulations thereunder, § 446(e) and § 1.446-1(e)(2) require a taxpayer to secure the consent of the Commissioner before changing a method of accounting for Federal tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to permit a taxpayer to obtain consent to change a method of accounting. Section 10 of this revenue procedure provides the procedures by which a taxpayer may obtain automatic consent for a change in method of accounting to use the methods of accounting provided by this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to a cable system operator, including a subsidiary or other downstream affiliate, that has a depreciable interest in cable network assets used in a cable system, as defined in sections 4.01 and 4.02 of this revenue procedure, that provides video, high-speed internet, and VOIP phone services. This revenue procedure does not apply to a taxpayer that is primarily a wireline or wireless telecommunications service provider. See Rev. Proc. 2011-27, 2011-18 I.R.B. 740, and

Rev. Proc. 2011-28, 2011-18 I.R.B. 743, for guidance applicable to wireline or wireless telecommunications service providers.

SECTION 4. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 Cable network assets. (1) Cable network assets mean personal or real property used in a cable system that provides video, high-speed internet, and VOIP phone services (“cable services”) to customer premises in the United States. Cable network assets consist of operating plant and equipment that receive signals and transmit programming from the headend, as defined in section 4.05 of this revenue procedure, to the customer, including signal receiving equipment, encoding and decoding devices, cables, connectors, switches, amplifiers, and distribution equipment at or near customer locations. Cable network assets do not include intangible property, other than computer software used in operating plant and equipment that provides cable services.

(2) Cable network assets do not include personal or real property (whether owned or leased) not directly used to provide cable services to customers, such as the following:

(a) Land. Any land;

(b) Land improvements. Any land improvements not directly used to provide cable services, such as a road;

(c) Non-cable network buildings and improvements. Non-cable network buildings and improvements consisting of real property, such as a corporate office building, call center, or service center;

(d) Furniture and fixtures. Furniture and fixtures;

(e) Equipment and machinery. General purpose office equipment (for example, printers and copiers);

(f) Vehicles. Transport motor vehicles; and

(g) Customer premises equipment. Customer premises equipment (“CPE”), which includes set-top boxes, modems, routers, and remotes used by customers to receive and select programming services. CPE also includes a customer connection box treated by a taxpayer as CPE and not treated as part of a customer drop.

.02 Cable system means a facility consisting of a set of closed transmission paths and associated signal generation, reception, and control equipment that provides cable services to multiple subscribers within a community, as defined in section 4.03 of this revenue procedure. In general, a cable system is the lowest reporting unit of a cable system operator and its affiliates at which they maintain their management reporting records. A single cable system can be owned by multiple taxpayers, who may each have different ownership interests in different individual assets that are part of the cable system.

.03 Community means one or more geographically contiguous or proximate customer populations receiving cable services under one or more nonexclusive franchises granted by one or more state or local franchising authorities.

.04 Cable distribution network means the network of property that conveys signals between the headend, as defined in section 4.05 of this revenue procedure, and customer premises, as defined in section 4.12 of this revenue procedure. The cable

distribution network generally consists of optic transmission and receiver devices, fiber optic cable, hubs, fiber optic transfer nodes, coaxial cable, amplifiers, taps, and customer drops.

.05 Headend means the primary location in a cable system that receives television programming signals (through satellite antennae or fiber optic cables) for distribution to the customer premises through a cable distribution network. Headend equipment includes computer-based electronic equipment that receives programming signals and uses prescribed processes to combine, amplify, and convert the programming signals and transmit them through the cable distribution network. The headend may include a headend building that houses headend equipment. The headend processes and combines signals for distribution to hubs, as defined in section 4.06 of this revenue procedure, or directly to customer premises. In most cases, the headend also serves as a distribution hub for the fiber optic transfer nodes closest to the headend. Headend also includes a “super headend,” which processes all incoming programming signals and transmits them to regional headends or directly to hubs.

.06 Hub means the secondary location in a cable system that is connected to the headend by fiber optic cable. A hub may contain electronic equipment that processes, converts, and transmits signals through the cable distribution network. A hub can serve a large number of business and residential communities.

.07 Fiber optic cable means a cable with flexible, transparent fiber made of very pure glass (silica) that transmits light between the two ends of the cable.

.08 Coaxial cable means an electric cable with an inner conductor surrounded by a flexible, tubular insulating layer that is further surrounded by a tubular conducting

shield (typically an inner conductor of copper, an insulating layer of nylon foam, and a conducting shield of an external aluminum wrap overlaid with copper or aluminum braid, all enclosed within a protective plastic cover).

.09 Node means any point within a cable distribution network where communication channels are interconnected. Generally, a fiber optic node contains a device that converts optical signals into radio frequency signals for distribution in coaxial cable portions of the cable distribution network.

.10 Amplifier means an electric component used to increase the strength of a transmitted signal within a cable distribution network.

.11 Tap means the equipment that is the final interconnection point within a cable distribution network and directs the signal to be delivered to a customer. A tap may be on a pole or in a pedestal on the ground. From the tap, the external drop runs to the customer premises.

.12 Customer premises means the final point of service and does not refer to any specific customer.

.13 Customer drop means the property that connects the tap with the customer premises. A customer drop may run aerially or underground. Multiple drops may connect to one tap. Customer drops include external drops and internal drops. A customer drop also includes a connection box or similar equipment that is not treated as CPE. A customer drop refers to the point of service, not to any specific customer.

.14 External drop means the cable and any associated connectors that run (aerial or underground) from the tap to the exterior of the customer premises.

.15 Internal drop means the cable and any associated connectors within the

interior of the customer premises.

SECTION 5. NETWORK ASSET MAINTENANCE ALLOWANCE METHOD FOR CABLE NETWORK ASSETS

.01 In general. Taxpayers generally must determine the amount of their cable network asset expenditures that may be deducted under § 162 and the amount of cable network asset expenditures that are required to be capitalized under § 263(a). Section 5.02 of this revenue procedure provides a method for determining the “network asset maintenance allowance” that may be deducted under § 162. Section 5.03 of this revenue procedure provides a method for determining the basis of cable network assets that are required to be capitalized under § 263(a). A taxpayer that uses the network asset maintenance allowance method described in this section 5 must use that method for all of its cable network asset costs, including subsequent costs relating to cable network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction subject to a § 338(g) or § 338(h)(10) election, even though the initial cost of such property is removed from the total cost of capital additions for the taxable year, as provided in paragraphs 5.02(2)(b)(iii) and (iv) of this section. If used by a taxpayer, the network asset maintenance allowance method described in this section 5 provides the exclusive means for determining for Federal tax purposes whether cable network asset costs that are capitalized for financial statement purposes are deductible or must be capitalized, except for costs for customer drops (section 7 of this revenue procedure provides methods for determining whether costs for customer drops are deductible or must be capitalized) and costs deductible under section 174. For instance, a taxpayer using the network asset maintenance allowance method described in this section 5 may

not determine whether cable network asset costs that are capitalized for financial statement purposes are deductible by applying the safe harbor for routine maintenance on property provided in § 1.263(a)-3(i).

.02 Network asset maintenance allowance. (1) The amount of the network asset maintenance allowance for a taxable year is determined using the methodology provided in paragraph 5.02(2). The methodology is a reclassification of cable network asset costs that are capitalized for a taxpayer's financial statements. Therefore, the network asset maintenance allowance is a deduction in addition to operation and maintenance costs that generally are deductible for both financial statement and Federal tax purposes. References in this revenue procedure to financial statements encompass financial information that supports the amount shown on a taxpayer's financial statement, including supporting schedules or statements.

(2) The amount of the network asset maintenance allowance for a taxable year is determined as follows:

(a) Start with the cost of cable network asset capital additions for financial statement purposes that are placed in service, within the meaning of § 1.46-3(d)(1)(ii), during the taxable year.

(b) Decrease the amount determined in paragraph 5.02(a) of this section by the following amounts:

(i) Customer drop costs capitalized for financial statement purposes;

(ii) Costs capitalized for financial statement purposes that are deducted or deferred for Federal tax purposes, other than under this

network asset maintenance allowance safe harbor, such as research and experimental expenditures under § 174;

(iii) The cost of cable network assets acquired during the taxable year in an applicable asset acquisition as defined in § 1060; and

(iv) The cost of cable network assets acquired during the taxable year in a transaction subject to a § 338(g) or § 338(h)(10) election.

(c) To determine the adjusted basis of the cable network assets under § 1011, make the adjustments required under § 1016 to the amount determined under paragraphs 5.02(2)(a) and (b) of this section to applicable 5-year property, 7-year property, 15-year property, and nonresidential real property, except do not make adjustments for the following:

(i) Basis adjustments attributable to changes in the taxpayer's definition of units of property made through a prior change in accounting method implemented before changing to the network asset maintenance allowance method provided in this revenue procedure;

(ii) Adjustments described in § 1016(a)(2) or § 1016(a)(3); or

(iii) Adjustments that require tax basis to be reduced before depreciation is computed (for example, §§ 179 and 179D; §§ 44 and 46).

(d) Multiply the adjusted basis of the cable network assets resulting from paragraph 5.02(2)(c) of this section by 12%. The result is the taxpayer's total network asset maintenance allowance amount for the taxable year, which may be deducted by the taxpayer under § 162.

.03 Allocation of basis to individual assets. The adjusted basis of the

cable network assets determined by applying paragraphs 5.02(2)(a), (b), and (c) of this section must be allocated to each cable network asset placed in service during the taxable year as described in this section. The allocation methodology provided in this paragraph 5.03 includes a reduction in the adjusted basis of the cable network assets to account for the total network asset maintenance allowance determined by applying paragraph 5.02(2)(d) of this section

(1) Start with the adjusted basis of 5-year property, 7-year property, 15-year property, and nonresidential real property determined by applying paragraphs 5.02(2)(a), (b), and (c) of this section.

(2) For each class of property, multiply the adjusted basis attributable to that class by 88%. The result is the adjusted basis for each class of property for the taxable year, which takes into account the network asset maintenance allowance amount determined by applying paragraph 5.02(2)(d) of this section.

(3) Next, based on the cost of the individual assets in each class of property, proportionally allocate the adjusted basis for each class of property determined by applying paragraph 5.03(2) of this section among each cable network asset in the class of property that is placed in service, within the meaning of § 1.46-3(d)(1)(ii), during the taxable year. Any cable network assets acquired during the taxable year in an applicable asset acquisition as defined in § 1060 or in a transaction subject to a § 338(g) or § 338(h)(10) election must be excluded from this calculation. See paragraph 5.03(5) of this section.

(4) The amount determined in paragraph 5.03(3) for each cable network asset is the basis of such asset to be used to determine the deductions allowable

or income tax credits available that require tax basis to be reduced before any depreciation is computed (for example, §§ 179 and 179D; §§ 44 and 46). The net amount for each cable network asset after the reduction in basis for such deductions and credits is the unadjusted depreciable basis of each asset for purposes of § 1.168(b)-1(a)(3).

(5) Expenditures for cable network assets acquired during the taxable year in an applicable asset acquisition as defined in § 1060 or in a transaction subject to a § 338(g) or § 338(h)(10) election are capital expenditures under § 263(a) to which ordinary basis and holding period rules apply.

.04 Example. B is a cable system operator that owns cable network assets. B changes its method of accounting to use the cable network asset maintenance allowance method provided in this revenue procedure. To determine the cable network asset maintenance allowance for the taxable year, B makes the following calculation:

Total cost of cable network asset capital additions for financial statement purposes that are placed in service, within the meaning of § 1.46-3(d)(1)(ii), during the taxable year (<u>see</u> paragraph 5.02(2)(a)).	\$ 900,000,000
<u>Less</u> : Customer drop costs capitalized for financial statement purposes (<u>see</u> paragraph 5.02(2)(b)(i)).	(\$100,000,000)
<u>Less</u> : Costs capitalized for financial statement purposes that are deducted or deferred for Federal tax purposes, other than under this network asset maintenance allowance safe harbor, such as research and experimental expenditures under § 174 (<u>see</u> paragraph 5.02(2)(b)(ii)).	(\$100,000,000)
<u>Less</u> : Cost of assets acquired during the taxable year in a § 1060 or a § 338(g) or § 338(h)(10) transaction (<u>see</u> paragraphs 5.02(2)(b)(iii) and (iv)).	(\$25,000,000)
<u>Less/Plus</u> : Other basis adjustments (excluding adjustments described in paragraphs 5.02(2)(c)(i), (ii), and (iii) of this section) (<u>see</u> paragraph 5.02(2)(c)).	<u>(\$5,000,000)</u>
Adjusted basis of the cable network assets (<u>see</u> paragraph 5.02(2)(c)).	\$670,000,000
<u>Multiply by</u> : Network asset maintenance allowance percentage (12%)	<u>X 12%</u>

(see paragraph (5.02(2)(d))).

Total network asset maintenance allowance amount (deductible under § 162) (see paragraph (5.02(2)(d))).

\$80,400,000

SECTION 6. UNITS OF PROPERTY FOR CABLE NETWORK ASSETS

.01 In general. For cable network assets, each of the following groupings constitutes a separate unit of property within an individual cable system for purposes of § 263(a):

- (1) All programming reception equipment, including antenna and satellite dishes;
- (2) All towers, antenna support structures, and satellite dish support structures affixed to foundations;
- (3) All concrete foundations upon which a tower, antenna support structure, or satellite support structure is installed, including the bolts embedded therein and other depreciable assets associated with the platform or other forms of anchoring to affix a tower, an antenna support structure, or a satellite support structure to a foundation;
- (4) Each headend building and each hub building (including its structural components);
- (5) The headend equipment, including computer-based electronic equipment that receives programming signals and uses prescribed processes to combine, amplify, and convert the programming signals and transmit them through the cable distribution network;
- (6) All depreciable land improvements, including (a) landscaping that is replaced when a related depreciable asset is replaced, (b) fences, and (c)

sidewalks, but excluding (d) enclosures, (e) buildings, and (f) any improvements properly capitalized to land;

(7) All equipment at the nodes;

(8) The fiber optic distribution system, including fiber optic cable, related PVC conduit and protective sheathing, and associated devices (including taps and drops), whether overhead or underground, but excluding permanent conduits and ducts; and

(9) The coaxial distribution system, including coaxial cable, related PVC conduit or protective sheathing, and associated devices (including taps and drops), whether overhead or underground, but excluding permanent conduits and ducts.

.02 Universal adoption not required. A taxpayer within the scope of this revenue procedure is not required to use all of the unit of property determinations provided in section 6.01 of this revenue procedure and, therefore, may use one or more of the unit of property determinations provided. Once used, however, a unit of property determination applies to all assets in that grouping, including assets subsequently acquired in an applicable asset acquisition as defined in § 1060 or in a transaction subject to a § 338(g) or § 338(h)(10) election.

.03 Limitation. The unit of property determinations provided in this revenue procedure shall not apply for any other purpose of the Code or regulations, including for determining the unit of property under other Code sections (for example, § 263A), or determining the asset for depreciation purposes (for example, placed-in-service date, dispositions, classification under § 168(e) or Rev. Proc. 87-56, 1987-2 C.B. 674, or for

purposes of § 168(j)), for the same or similar-type assets.

SECTION 7. CUSTOMER DROP AND CPE INSTALLATION COSTS

.01 Taxpayers may use either the method described in paragraph (1) of this section or the method described in paragraph (2) of this section for determining whether customer drops costs (including installation costs) may be deducted under § 162 or must be capitalized under § 263(a).

(1) Specific identification method. Taxpayers may specifically identify their costs for customer drops and CPE installations and treat them as follows:

(a) Initial external drops. The direct and indirect costs associated with installing an initial external drop must be capitalized, unless the costs are otherwise deductible under another provision of the Code or regulations.

(b) Replacement external drops. The direct and indirect costs associated with replacing an external drop that do not result in a betterment (§ 1.263(a)-3(j)) or an adaption to a new or different use (§ 1.263(a)-3(l)) may be deducted.

(c) Improved external drops. The direct and indirect costs associated with replacing an external drop that result in a betterment (§ 1.263(a)-3(j)) or an adaption to a new or different use (§ 1.263(a)-3(l)) must be capitalized, unless the costs are otherwise deductible under another provision of the Code or regulations.

(d) Internal drops. The direct and indirect costs associated with installing or replacing any internal drop may be deducted.

(2) Safe-harbor allocation method. As an alternative to the specific identification method described in paragraph 7.01(1) of this section, taxpayers may treat customer drop costs as follows:

(a) Methodology. Allocate an amount equal to 12% of total customer drop costs for the taxable year to initial external drops and treat those costs as expenditures to be capitalized under § 263(a). Allocate the remaining 88% of total customer drop costs for the taxable year to internal drop costs and drop replacement costs, and treat those costs as deductible expenditures, except for the expenditures described in paragraph 7.01(2)(b) of this section.

(b) Cable system improvements. Notwithstanding paragraph 7.01(2)(a) of this section, the direct and indirect costs associated with replacing an external drop that result in a betterment (§ 1.263(a)-3(j)) or an adaption to a new or different use (§ 1.263(a)-3(l)) must be capitalized, unless the costs are otherwise deductible under another provision of the Code or regulations.

.02 CPE costs. In general, whether the costs of acquiring CPE must be capitalized is determined under the general rules of the Code and regulations, such as § 263(a) and the corresponding regulations. The labor costs associated with installing CPE may be treated as expenditures deductible under § 162.

SECTION 8. DEPRECIATION OF FIBER OPTIC NODE AND CABLE

.01 In general. This section 8 provides a safe harbor method of accounting under which the IRS will treat a fiber optic transfer node and trunk line consisting of fiber

optic cable used in a cable distribution network providing both one-way and two-way communication services as the asset for computing depreciation under §§ 167 and 168.

.02 Definitions. The following definitions apply solely for purposes of section 8 of this revenue procedure:

(1) Node means a fiber optic transfer node of the cable distribution network.

(2) Fiber optic cable means fiber optic cable that is used as a trunk line.

.03 Safe harbor method. (1) Asset. The asset for calculating depreciation under §§ 167 and 168 and the regulations thereunder is a node and the fiber optic cable to that node, excluding any fiber optic cable previously considered placed in service under section 8.03(2) of this revenue procedure or under section 4.03 of Rev. Proc. 2003-63, 2003-2 C.B. 304, and any optic fibers sold by the taxpayer.

(2) Placed in service. The asset described in paragraph 8.03(1) of this section is considered placed in service for depreciation purposes when placed in a condition or state of readiness and availability for its specifically assigned function. The specifically assigned function of a cable operator's cable system is to provide services to subscribers. Thus, when a node is connected to the equipment necessary for providing one-way or two-way communication services to subscribers, or potential subscribers, the property is considered placed in service for depreciation purposes. Although a fiber optic cable may contain more optic fibers than are necessary to serve a single node, all optic fibers in the asset are considered placed in service when the node is ready and available as described above and connected to at least one optic fiber in the fiber optic cable.

(3) Consistent treatment. A taxpayer using the asset described in paragraph 8.03(1) of this section must use it for all of the nodes and fiber optic cable connected to an individual headend. Taxpayers also are required to treat the asset consistently for all purposes under §§ 167 and 168 and the regulations thereunder.

(4) Example. Taxpayer has a fiber optic cable containing 20 bundles of 6 optic fibers each (120 total optic fibers) and initially connects 2 optic fibers to the node in taxable year X. Assume that the node is connected to the equipment necessary for providing one-way or two-way communication services to subscribers or potential subscribers. The fiber optic cable (including all 120 optic fibers) and the node are the asset for depreciation purposes. The fiber optic node and cable is considered placed in service in taxable year X, even though only 2 of the 120 optic fibers are connected.

SECTION 9. PRIMARY USE

.01 In general. This section 9 provides guidance for determining whether a cable network asset, other than a headend, used in a cable system and described in asset class 48.42 (CATV-Subscriber Connection and Distribution Systems) of Rev. Proc. 87-56, 1987-2 C.B. 674, (“tested asset”) is primarily used, within the meaning of § 1.167(a)-11(b)(4)(iii)(b), for providing one-way or two-way communication services to subscribers, including a safe harbor manner for determining primary use.

.02 Definitions. The following definitions apply solely for purposes of section 9 of this revenue procedure:

(1) Video service means video service that is not provided via internet

broadband service, including multi-channel, on-demand, and other video service.

(2) Telephony service means bi-directional voice communication.

(3) Broadband service means internet or high-speed data telecommunications provided via multiple channels of data over a single communications medium.

(4) Signal traffic or internet delivery protocols means internet or high-speed-data signal traffic that can be either one-way or two-way communication.

(5) One-way signal traffic means signal traffic associated with streaming protocols (video and audio) and file transfer protocols (bulk file downloads).

(6) Two-way signal traffic means signal traffic associated with protocols other than one-way signal traffic.

(7) One-way communication services means communication services that are primarily transmitted downstream, including the following internet or high-speed data-signal traffic:

- (a) Video streaming;
- (b) Cable television;
- (c) Video programming;
- (d) Web-video streaming;
- (e) Over-the-top video;
- (f) Real-time entertainment video;
- (g) Bulk entertainment;
- (h) Audio streaming; and
- (i) Other video signals sent only downstream regardless of delivery

protocols.

(8) Two-way communication services means all communication services other than one-way communication services. Two way communication services transmit internet or high-speed data-signal traffic both upstream and downstream. Two-way communication services include the following internet or high-speed data-signal traffic:

- (a) File exchange protocol;
- (b) Email;
- (c) Voice-over-internet protocols;
- (d) Peer-to-peer communications, such as video conferencing;
- (e) Instant messaging;
- (f) Gaming; and
- (g) Other similar communication services equivalent to telephone communications.

.03 Determining primary use.

(1) General rule. In determining whether a tested asset is primarily used, within the meaning of § 1.167(a)-11(b)(4)(iii)(b), for providing one-way or two-way communication services to subscribers, a taxpayer must determine primary use by using any reasonable manner that is consistently applied within a taxable year to the taxpayer's tested asset. If a tested asset is primarily used for providing one-way communication services, the asset is included in asset class 48.42 and classified as 7-year property under § 168(e)(1), with a recovery period of 7 years under § 168(c) and a recovery period of 10 years under § 168(g). If a tested

asset is primarily used for providing two-way communication services, the asset is classified as 15-year property pursuant to § 168(e)(3)(E)(ii), with a recovery period of 15 years under § 168(c) and a recovery period of 24 years under § 168(g).

(2) Reasonable manner. A reasonable manner includes, but is not limited to, determining primary use by gross receipts or by subscriber count for each service within the applicable cable system, as well as the safe harbor manner provided by paragraph 9.03(3) of this section. Determining primary use solely by bandwidth is not reasonable. A taxpayer may use different reasonable manners to determine primary use from taxable year to taxable year.

(3) Safe harbor manner for determining primary use. The following safe harbor manner is reasonable for determining primary use under paragraph 9.03(1) of this section for a taxable year. This manner for making the factual primary use determination applies solely for depreciation purposes and is applied at the cable system level. Thus, for the taxable year for which the safe harbor is applied to one or more cable systems, the safe harbor must be used for all of the taxpayer's tested assets in each cable system to which the safe harbor is applied.

(a) Identification of total revenue. Total revenue of the cable system generated by the use of tested assets must be identified.

(i) Revenue generated by the use of tested assets includes the following:

(A) Video service revenue;

(B) Telephony service revenue;

(C) Home monitoring revenue;

(D) Broadband service revenue;

(E) Revenue derived from leasing or otherwise providing the right to use optical fibers or one or more fiber optic cables in the cable system; and

(F) Any other revenue generated by the use of tested assets identified in guidance published in the Internal Revenue Bulletin.

(ii) The revenue identified in paragraphs 9.03(3)(a)(i) of this section includes all of the following sub-categories of revenue:

(A) Service revenue;

(B) Advertising revenue;

(C) Equipment rental;

(D) Installation fees; and

(E) Early service termination fees.

(iii) Total revenue generated by the use of tested assets excludes franchise fee revenue.

(b) Substantiation of total revenue. For purposes of paragraph 9.03(3)(a) of this section, revenue generated by the use of a tested asset may be substantiated by either of the following:

(i) Revenue reported on a taxpayer's financial statements, including the financial statements themselves and information

contained on schedules or statements supporting the financial statements; or

(ii) Company reports (and supporting data) used for regulatory reporting of revenue for the following services:

(A) Video service;

(B) Telephony service;

(C) Broadband service; or

(D) Other similar services provided by the taxpayer.

(c) Determination of one-way or two-way communication services revenue. The revenue identified in paragraph 9.03(3)(a) of this section must be treated as revenue from one-way communication services or two-way communication services, using the methodology described in paragraphs 9.03(3)(c)(i)-(iv) of this section.

(i) One-way communication services revenue. The following revenue must be treated as revenue from one-way communication services:

(A) Video service revenue; and

(B) Any additional revenue treated as revenue from one-way communication services in guidance published in the Internal Revenue Bulletin.

(ii) Two-way communication services revenue. The following revenue must be treated as revenue from two-way communication services:

(A) Telephony service revenue;

(B) Home monitoring revenue; and

(C) Any additional revenue treated as revenue from two-way communication services in guidance published in the Internal Revenue Bulletin.

(iii) Presumptive two-way communication services revenue.

Revenue derived from leasing or otherwise providing the right to use optical fibers or one or more fiber optic cables in the cable system is presumptively treated as revenue from two-way communication services, unless the taxpayer can substantiate through reasonable means that the revenue is from one-way communication services.

(iv) Allocated revenue. (A) Revenue to be allocated between one-way and two-way. The following types of revenue must be allocated between revenue from one-way communication services and revenue from two-way communication services:

a. Broadband service revenue; and

b. Any additional revenue treated as revenue that must be allocated between revenue from one-way communication services and revenue from two-way communication services in guidance published in the Internal Revenue Bulletin.

(B) Allocation between one-way and two-way

communication services revenue. The allocation between revenue from one-way communication services and revenue from two-way communication services required by this paragraph 9.03(c)(iii) is determined pro rata, based on the ratio of one-way signal traffic to two-way signal traffic, determined from either of the following data sources:

- a. Average signal traffic data determined from the taxpayer's records for the taxable year; or
- b. Industry average signal traffic data published by commercially available third-party sources (not including news media outlets) for the taxable year or the most recent period available.

(d) Primary use determination. Primary use is determined based on total revenue under paragraph 9.03(3)(a) of this section and the one-way and two-way communication services revenue determinations under paragraph 9.03(3)(c) of this section. If total cable system revenue from one-way communication services is greater than total cable system revenue from two-way communication services for a taxable year, then the primary use of the tested assets in the cable system is for providing one-way communication services for that taxable year. If total cable system revenue from two-way communication services is greater than total cable system revenue from one-way communication services for a taxable year, then the primary use of tested assets in the cable system is for providing

two-way communication services for that taxable year.

.04 Example. Z is a cable system operator that owns cable network assets. Z uses the safe harbor manner provided by paragraph 9.03(3) of this section to determine whether the primary use of Z's tested assets used in cable system S is for one-way or two-way communications for the taxable year.

During the taxable year, Z has the following total revenue generated by the use of tested assets in cable system S:

Video service	Service revenue	\$10,000,000	
	Advertising revenue	\$4,000,000	
	Equipment rental	\$650,000	
	Video installation fees	\$250,000	
	Early termination fees	\$100,000	
			<hr/> \$15,000,000
Telephony service	Service revenue	\$2,500,000	
	Advertising revenue	\$0	
	Equipment rental	\$325,000	
	Installation fees	\$125,000	
	Early termination fees	\$50,000	
			<hr/> \$3,000,000
Home monitoring	Service revenue	\$1,000,000	
	Advertising Revenue	\$0	
	Equipment rental	\$750,000	
	Installation fees	\$150,000	
	Early termination fees	\$100,000	
			<hr/> \$2,000,000
Broadband service	Service revenue	\$8,000,000	
	Advertising revenue	\$1,000,000	
	Equipment rental	\$500,000	
	Installation fees	\$400,000	

	Early termination fees	\$100,000	
			<u>\$10,000,000</u>
Optical fiber leasing		\$500,000	\$500,000
	Total revenue		<u>\$30,500,000</u>

Under the safe harbor manner for determining primary use, the video service revenue (\$15,000,000) is treated as revenue from one-way communication services, and the telephony service revenue (\$3,000,000) and the home monitoring revenue (\$2,000,000) are treated as revenue from two-way communication services. The revenue derived from leasing certain optical fibers (\$500,000) is treated as revenue from two-way communication services unless Z can substantiate through reasonable means that the revenue is from one-way communication services. In this instance, Z does not know how the lessor is using the leased optical fiber, so the \$500,000 is treated as revenue from two-way communication services.

Under the safe harbor manner for determining primary use, Z must allocate its broadband service revenue pro rata between revenue from one-way communication services and revenue from two-way communication services based on a comparison of one-way signal traffic to two-way signal traffic. Published industry data establish that during the taxable year 58% of signal traffic is one-way signal traffic and 42% of signal traffic is two-way signal traffic. Therefore, \$5,800,000 ($\$10,000,000 \times 58\%$) of Z's broadband service revenue must be treated as revenue from one-way communication services, and \$4,200,000 ($\$10,000,000 \times 42\%$) of Z's broadband service revenue must be treated as revenue from two-way communication services.

To determine whether the primary use for the taxable year of all of Z's tested assets used in cable system S is for one-way or two-way communication services, Z

compares total cable system S revenue from one-way communication services for the taxable year to total cable system revenue from two-way communication services for the taxable year. Cable system S revenue from one-way communication services totals \$20,800,000 (\$15,000,000 + \$5,800,000). Cable system S revenue from two-way communication services totals \$9,700,000 (\$3,000,000 + \$2,000,000 + \$500,000 + \$4,200,000), which is less than the total cable system revenue from one-way communication services. Therefore, under the safe harbor manner for primary use provided by section 9.03(3) of this revenue procedure, for the taxable year all of Z's tested assets used in a cable system S are primarily used for one-way communication services.

.05 Change in use. Section 168(i)(5) and § 1.168(i)-4 apply for determining depreciation of an asset beginning in the year of the change (as defined in § 1.168(i)-4(a)) if the primary use (determined under section 9.03(1) or section 9.03(2)) of tested asset changes--

(1) From providing one-way communication services to providing two-way communication services; or

(2) From providing two-way communication services to providing one-way communication services.

SECTION 10. CHANGE IN METHOD OF ACCOUNTING

.01 In general. Each of the following is a change in method of accounting to which the provisions of §§ 446 and 481, and the regulations thereunder, apply:

(1) A change to use the network asset maintenance allowance method for cable network assets provided in section 5 of this revenue procedure;

(2) A change to use any of the unit of property definitions provided in section 6 of this revenue procedure;

(3) A change to use the specific identification method for customer drops provided in section 7.01(1) of this revenue procedure;

(4) A change to use the safe harbor allocation method for external drops provided in section 7.01(2) of this revenue procedure;

(5) A change to deduct the labor costs associated with installing CPE provided in section 7.02 of this revenue procedure; and

(6) A change to the safe harbor method provided in section 8.03 of this revenue procedure for determining the asset and placed-in-service date under §§ 167 and 168 for a fiber optic transfer node and trunk line that consists of fiber optic cable used in a cable distribution network providing one-way and two-way communication services and that is placed in service in taxable years ending on or after December 30, 2003. A taxpayer also may treat a change to the safe harbor method for determining the asset provided in section 8.03 of this revenue procedure for a fiber optic transfer node and trunk line that consists of fiber optic cable used in a cable distribution network providing one-way and two-way communication services and that is placed in service in taxable years ending before December 30, 2003, as a change in method of accounting to which the provisions of §§ 446 and 481, and the regulations thereunder, apply.

.02 Automatic changes.

(1) A taxpayer that wants to change to a method of accounting described in this revenue procedure must use the automatic change in method of

accounting provisions in Rev. Proc. 2011-14, 2011-4 I.R.B. 330, as modified by this revenue procedure, or its successor.

(2) Rev. Proc. 2011-14 is modified to add new section 3.21 to the APPENDIX, to read as follows:

3.21 Cable network asset capitalization methods of accounting under Rev. Proc. 2015-12.

(1) Description of change. This change applies to a cable system operator that is within the scope of Rev. Proc. 2015-12, 2015-2 I.R.B., and wants to make one or more of the following changes in method of accounting:

(a) Change its treatment of cable network asset expenditures to the cable network asset maintenance allowance method of accounting provided in section 5 of Rev. Proc. 2015-12;

(b) Change to use any of the unit of property definitions provided in section 6 of Rev. Proc. 2015-12;

(c) Change to use the specific identification method for installations and customer drop costs described in section 7.01(1) of Rev. Proc. 2015-12;

(d) Change to use the safe harbor allocation method for installations and customer drop costs described in section 7.01(2) of Rev. Proc. 2015-12; or

(e) Change to deduct the labor costs associated with installing customer premises equipment under section 7.02 of Rev.

Proc. 2015-12.

(2) Scope limitations inapplicable. The scope limitations in section 4.02 of this revenue procedure do not apply to a cable system operator that changes to a method of accounting provided in section 5, section 6, or section 7 of Rev. Proc. 2015-12 for its first or second taxable year ending after December 31, 2013.

(3) Audit protection limited. A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change, or a concurrent automatic change permitted under section (4) of this change, if the method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court. See sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(4) Concurrent automatic change. A taxpayer that wants to make both one or more changes in method of accounting pursuant to this section 3.21 of the APPENDIX and a change to a UNICAP method pursuant to the APPENDIX for the same year of change should file a single Form 3115 that includes all of these changes and must enter the designated automatic accounting method change numbers for all of these changes on the appropriate line on the Form 3115. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure.

(5) Section 481(a) adjustment.

(a) In general, a change to one or more of the changes in method of accounting described in paragraph (1) of this section requires an adjustment under § 481(a). The § 481(a) adjustment shall not include any amount attributable to property for which the taxpayer elected to apply the repair allowance under § 1.167(a)-11(d)(2).

(b) Itemized listing on Form 3115. The taxpayer must include on Form 3115, Part IV, line 25, the total § 481(a) adjustment for all changes in methods of accounting being made. If the taxpayer is making more than one change in method of accounting under Rev. Proc. 2015-12, the taxpayer must include on an attachment to Form 3115 --

(i) the information required by Part IV, line 25 for each change in method of accounting (including the amount of the § 481(a) adjustment for each change in method of accounting, which includes the portion of the § 481(a) adjustment attributable to UNICAP);

(ii) the information required by Part II, line 12 of Form 3115 that is associated with each change; and

(iii) the citation to the paragraph of Rev. Proc. 2015-12 that provides for each proposed method of accounting.

(6) Ogden copy of Form 3115 required in lieu of national office

copy. A taxpayer changing its method of accounting under this section 3.21 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT (Ogden copy) in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its Federal income tax return for the year of change. See section 6.02(3)(a)(ii)(B) (providing the general rules) and section 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(7) Designated automatic accounting method change number. The designated automatic accounting method change number for a change to a method of accounting provided in section 5 or 6 of Rev. Proc. 2015-12 is “208.” The designated automatic accounting method change number for a change to a method of accounting provided in section 7 of Rev. Proc. 2015-12 is “209.”

(8) Contact information. For further information regarding a change under this section, contact Merrill Feldstein at (202) 317-5100.

(3) Rev. Proc. 2011-14 is modified to add new section 6.41 to the APPENDIX to read as follows:

6.41 Depreciation of fiber optic transfer node and fiber optic cable used by a cable system operator (§§ 167 and 168)

(1) Description of change.

(a) Applicability. This change applies to a cable system operator that is within the scope of Rev. Proc. 2015-12, 2015-2

I.R.B., and wants to change to the safe harbor method of accounting provided in section 8.03 of Rev. Proc. 2015-12 for determining depreciation under §§ 167 and 168 of a fiber optic transfer node and trunk line consisting of fiber optic cable used in a cable distribution network providing one-way and two-way communication services. The safe harbor method provided by section 8.03 of Rev. Proc. 2015-12 determines the asset for purposes of §§ 167 and 168.

(b) Inapplicability. This change does not apply to the following:

(i) any property that is not depreciated under § 168 under the taxpayer's present and proposed methods of accounting; or

(ii) any property that is not owned by the taxpayer at the beginning of the year of change.

(2) Scope limitations inapplicable.

(a) The scope limitations in section 4.02(1), (2), (3), (4), (6), and (7) of this revenue procedure do not apply to a taxpayer that makes this change for its first or second taxable year ending after December 31, 2013.

(b) The scope limitation in section 4.02(5) of this revenue procedure does not apply to a taxpayer that makes this change.

(3) Audit protection limited. A taxpayer does not receive audit

protection under section 7 of this revenue procedure in connection with this change, or a concurrent automatic change permitted under section (4)(b) of this change, if the method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court. See sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(4) Concurrent automatic change.

(a) A taxpayer that wants to make this change for more than one asset for the same year of change should file a single Form 3115 for all such assets and provide a single net § 481(a) adjustment for all the changes included in that Form 3115. If one or more of the changes in that single Form 3115 generate a negative § 481(a) adjustment and other changes in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all the changes that are included in that Form 3115 generating such adjustment and a single positive § 481(a) adjustment for all the changes that are included in that Form 3115 generating such adjustment.

(b) A taxpayer that wants to make both this change and a change to a UNICAP method under section 11.01, 11.02, or 11.09 of this APPENDIX, as applicable, for the same year of change should file a single Form 3115 for all such changes and must enter

the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure.

(5) Ogden copy of Form 3115 required in lieu of national office copy. A taxpayer changing its method of accounting under section 6.41 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT (Ogden copy) in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its Federal income tax return for the year of change. If a taxpayer makes both this change and a change to a UNICAP method under section 11.01, 11.02, or 11.09 of this APPENDIX, as applicable, on a single Form 3115 for the same year of change in accordance with section 6.41(3)(b) of this APPENDIX, the taxpayer must file a signed copy of that completed Form 3115 with the IRS in Ogden, UT (Ogden copy) in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its Federal income tax return for the year of change. See section 6.02(3)(a)(ii)(B) (providing the general rules) and section 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(6) Designated automatic accounting method change number. The designated automatic accounting method change number for a change to

the method of accounting under section 6.41 of this APPENDIX is “210.”

See section 6.02(4) of this revenue procedure.

(7) Contact information. For further information regarding a change under this section, contact Charles Magee at (202) 317-7005 (not a toll-free call).

(4) Section 6.08 of the APPENDIX of Rev. Proc. 2011-14 is modified by adding a new sentence at the end of section 6.08(1) of the APPENDIX, to read as follows: This change applies only to taxable years ending on or before December 31, 2013. For taxable years ending after December 31, 2013, see section 6.41 of this APPENDIX for making a change to the safe harbor method of accounting provided in section 8.03 of Rev. Proc. 2015-12, 2015-2 I.R.B., for depreciation of fiber optic transfer node and trunk line consisting of fiber optic cable used in a cable distribution network. The safe harbor method of accounting provided in section 8.03 of Rev. Proc. 2015-12 determines the asset for purposes of §§ 167 and 168. See section 9 of Rev. Proc. 2015-12 for the safe harbor manner of determining the primary use of that asset for taxable years ending after December 31, 2013.

SECTION 11. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2003-63 is superseded.

.02 Rev. Proc. 2011-14 is modified.

SECTION 12. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending after December 31, 2013.

SECTION 13. DRAFTING INFORMATION

The principal author of this revenue procedure is Alan S. Williams of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding sections 5, 6, 7, 10.01, or 10.02(2) of this revenue procedure contact Merrill Feldstein at 202-317-5100 (not a toll free call). For further information regarding sections 8, 9, 10.02(3), or 10.02(4) of this revenue procedure contact Charles Magee of the Office of Associate Chief Counsel (Income Tax & Accounting) at 202-317-7005 (not a toll free call).